

Internal Revenue Service, Treasury

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to the fair market value of the corpus (including all accumulated earnings, profits, or gains attributable to the corpus) of the entire foreign trust.

(c) *Examples.* The provisions of paragraph (b) of this section may be illustrated by the following examples. Example 1 illustrates the application of paragraph (b)(2) of this section. Example (2) illustrates the application of paragraph (b)(3) of this section in a case where there is no provision in the governing instrument of the trust or elsewhere which would require the trustee to treat the corpus of the trust as composed of more than one fund.

Example 1. On January 1, 1964, the date of the creation of a foreign trust, a U.S. person transfers to it stock of a U.S. corporation with a fair market value of \$50,000. On the same day, a person other than a U.S. person transfers to the trust Country X bonds with a fair market value of \$25,000. The governing instrument of the trust provides that the income from the stock of the U.S. corporation is to be accumulated until A, a U.S. beneficiary, reaches the age of 21 years, and upon his reaching that age, the stock and income accumulated thereon are to be distributed to him. The governing instrument of the trust further provides that the income from the Country X bonds is to be accumulated until B, a U.S. beneficiary, reaches the age of 21 years, and upon his reaching that age, the bonds and income accumulated thereon are to be distributed to him. To comply with the provisions of the governing instrument of the trust that the income from the stock of the U.S. corporation be accumulated and distributed to A and that the income from the Country X bonds be accumulated and distributed to B, it is necessary that the trustee treat the transfers as two separate funds. The fund consisting of the stock of the U.S. corporation is a foreign trust created by a U.S. person.

Example 2. On January 1, 1964, the date of the creation of a foreign trust, a U.S. person transfers to it property having a fair market value of \$60,000 and a person other than a U.S. person transfers to it property having a fair market value of \$40,000. Immediately after these transfers, the foreign trust created by a U.S. person is 60 percent of the entire foreign trust, determined as follows:

\$60,000 (Value of property transferred by U.S. person)/\$100,000 (Value of entire property transferred to trust)=60 percent

The undistributed net income for the calendar years 1964 and 1965 is \$20,000 which increases the value of the entire foreign trust to \$120,000 (\$100,000 plus \$20,000). Accordingly, as of December 31, 1965, the portion of the

foreign trust created by the U.S. person is \$72,000 (60 percent of \$120,000). On January 1, 1966, the U.S. person transfers property having a fair market value of \$40,000 increasing the value of the entire foreign trust to \$160,000 (\$120,000 plus \$40,000) and increasing the value of the portion of the foreign trust created by the U.S. person to \$112,000 (\$72,000 plus \$40,000). Immediately, after this transfer, the foreign trust created by the U.S. person is 70 percent of the entire foreign trust, determined as follows:

\$112,000 (Value of property transferred by U.S. person)/\$160,000 (Value of entire property transferred to the trust)=70 percent

[T.D. 6989, 34 FR 732, Jan. 17, 1969]

§ 1.643(d)-2 Illustration of the provisions of section 643.

(a) The provisions of section 643 may be illustrated by the following example:

Example. (1) Under the terms of the trust instrument, the income of a trust is required to be currently distributed to W during her life. Capital gains are allocable to corpus and all expenses are charges against corpus. During the taxable year the trust has the following items of income and expenses:

Dividends from domestic corporations	\$30,000
Extraordinary dividends allocated to corpus by the trustee in good faith	20,000
Taxable interest	10,000
Tax-exempt interest	10,000
Long-term capital gains	10,000
Trustee's commissions and miscellaneous expenses allocable to corpus	5,000

(2) The "income" of the trust determined under section 643(b) which is currently distributable to W is \$50,000, consisting of dividends of \$30,000, taxable interest of \$10,000, and tax-exempt interest of \$10,000. The trustee's commissions and miscellaneous expenses allocable to tax-exempt interest amount to \$1,000 ($10,000/50,000 \times 5,000$).

(3) The "distributable net income" determined under section 643(a) amounts to \$45,000, computed as follows:

Dividends from domestic corporations	\$30,000
Taxable interest	10,000
Nontaxable interest	\$10,000
Less: Expenses allocable thereto	1,000
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	9,000
Total	49,000
Less: Expenses (\$5,000 less \$1,000 allocable to tax-exempt interest)	4,000
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Distributable net income	45,000

In determining the distributable net income of \$45,000, the taxable income of the trust is computed with the following modifications: No deductions are allowed for distributions to W and for personal exemption of the trust

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(section 643(a) (1) and (2)); capital gains allocable to corpus are excluded and the deduction allowable under section 1202 is not taken into account (section 643(a)(3)); the extraordinary dividends allocated to corpus by the trustee in good faith are excluded (sections 643(a)(4)); and the tax-exempt interest (as adjusted for expenses) and the dividend exclusion of \$50 are included) section 643(a) (5) and (7)).

(b) See paragraph (c) of the example in § 1.661(c)-2 for the computation of distributable net income where there is a charitable contributions deduction.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960. Redesignated, T.D. 6989, 34 FR 732, Jan. 1, 1969]

§ 1.643(h)-1 Distributions by certain foreign trusts through intermediaries.

(a) *In general*—(1) *Principal purpose of tax avoidance*. Except as provided in paragraph (b) of this section, for purposes of part I of subchapter J, chapter 1 of the Internal Revenue Code, and section 6048, any property (within the meaning of paragraph (f) of this section) that is transferred to a United States person by another person (an intermediary) who has received property from a foreign trust will be treated as property transferred directly by the foreign trust to the United States person if the intermediary received the property from the foreign trust pursuant to a plan one of the principal purposes of which was the avoidance of United States tax.

(2) *Principal purpose of tax avoidance deemed to exist*. For purposes of paragraph (a)(1) of this section, a transfer will be deemed to have been made pursuant to a plan one of the principal purposes of which was the avoidance of United States tax if the United States person—

(i) Is related (within the meaning of paragraph (e) of this section) to a grantor of the foreign trust, or has another relationship with a grantor of the foreign trust that establishes a reasonable basis for concluding that the grantor of the foreign trust would make a gratuitous transfer (within the meaning of § 1.671-2(e)(2)) to the United States person;

(ii) Receives from the intermediary, within the period beginning twenty-four months before and ending twenty-four months after the intermediary's

receipt of property from the foreign trust, either the property the intermediary received from the foreign trust, proceeds from such property, or property in substitution for such property; and

(iii) Cannot demonstrate to the satisfaction of the Commissioner that—

(A) The intermediary has a relationship with the United States person that establishes a reasonable basis for concluding that the intermediary would make a gratuitous transfer to the United States person;

(B) The intermediary acted independently of the grantor and the trustee of the foreign trust;

(C) The intermediary is not an agent of the United States person under generally applicable United States agency principles; and

(D) The United States person timely complied with the reporting requirements of section 6039F, if applicable, if the intermediary is a foreign person.

(b) *Exceptions*—(1) *Nongratuitous transfers*. Paragraph (a) of this section does not apply to the extent that either the transfer from the foreign trust to the intermediary or the transfer from the intermediary to the United States person is a transfer that is not a gratuitous transfer within the meaning of § 1.671-2(e)(2).

(2) *Grantor as intermediary*. Paragraph (a) of this section does not apply if the intermediary is the grantor of the portion of the trust from which the property that is transferred is derived. For the definition of *grantor*, see § 1.671-2(e).

(c) *Effect of disregarding intermediary*—(1) *General rule*. Except as provided in paragraph (c)(2) of this section, the intermediary is treated as an agent of the foreign trust, and the property is treated as transferred to the United States person in the year the property is transferred, or made available, by the intermediary to the United States person. The fair market value of the property transferred is determined as of the date of the transfer by the intermediary to the United States person. For purposes of section 665(d)(2), the term *taxes imposed on the trust* includes any income, war profits, and excess profits taxes imposed by any foreign country or possession of the United